BEFORE THE

Federal Communications Commission

IN THE MATTER OF	)	
	)	
IMPLEMENTATION OF SECTIONS OF THE CABLE TELEVISION CONSUMER PROTECTION AND COMPETITION ACT OF 1992	)	MM Docket 92-266
	)	
Rate Regulation	)	

To: The Commission

COMMENTS OF USA NETWORKS

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It is imperative that the requirements of the Cable Act of 1992 regarding rate regulation be implemented in a way which preserves and promotes program quality, originality and choice to the maximum extent possible. In these comments, USA Networks addresses three aspects of the Commission's proposed regulations that significantly affect the fulfillment of these goals: the need for a mechanism permitting the pass-through of changes in direct program costs of cable networks; the need to develop a benchmark for initial rates that reflects the contribution made by cable networks to consumer interests; and the need to deal with complaints about upper-tier rates on a case-by-case basis.[1/]

1/ We do not believe it necessary to respond to the Commission's proposed implementation of the Negative Option Billing provision of the Cable Act. Section 623(f). The Commission tentatively finds that additions to a tier that involves a price increase justifiable under the applicable rate regulation standard, or no rate increase, are not subject to the negative option billing restrictions. Notice of Proposed Rulemaking at ¶ 120 ("NPRM"). That finding is correct.

SUMMARY OF POSITION

The adoption of a regulatory mechanism that permits cable operators to automatically pass through to subscribers changes in the direct cost of programming associated with the carriage of cable networks in the basic tier is permitted by the Act, encouraged by its legislative history and absolutely indispensable to the preservation of consumer choice. This rule will provide cable operators with an incentive to provide a broad diversity of quality cable networks as a part of the basic tier. It will assure cable networks access to the audience they need to enhance their services. It will enable subscribers to continue to enjoy, as a part of basic service, a choice of high quality programming from a diversity of sources.

Although benchmarking is the appropriate method of regulating basic tier rates, the benchmark should not be determined simply on an average per channel basis. Per channel averaging would encourage cable operators to discard quality program services in favor of less attractive, less expensive services in the basic tier. The basic goals of the 1992 Cable Act will be reflected better by grouping systems by the number of channels included in the basic tier and by the quality of such services.

The determination whether upper-tier rates are "unreasonable" depends upon an assessment of a number of variables including the composition and price of the basic tier, the differential in price between basic and upper tiers, and penetration levels of the basic

and upper tier. There is no formulaic means of accounting for and weighing the relevant factors. The Commission should address the question of unreasonableness of upper tier rates on a case-by-case basis.

THE BASIC TIER REGULATORY REGIME MUST INCLUDE A PASS-THROUGH OF THE DIRECT COST OF PROGRAMMING ASSOCIATED WITH CABLE NETWORKS

1. Section 623(b) of the Act specifically provides that the "formula" adopted by the Commission for the regulation of basic tier rates must take account of the direct costs of obtaining cable programming carried on the basic tier and "changes in such costs." Section 623(b)(2)(C)(ii). The legislative history makes plain that basic tier rate changes that have occurred in the years since passage of the 1984 Act resulting from the inclusion of high quality and innovative basic cable networks in the lowest priced tier did not form any part of the legislative decision to reimpose rate regulation. H. Rep. No. 628, 102d Cong., 2d Sess. at 79 ("House Report"). Therefore, Congress did not intend that the "formula" for determining the reasonableness of basic tier rates adopted by the Commission would have the effect of encouraging a restructuring of basic tier offerings. On the contrary, the House Report directs the Commission to "recognize that changes in the direct cost of programming are likely to occur during a rate cycle" and urges the adoption of regulations designed to assure that cable programmers are "fairly compensated for the service they provide

to cable subscribers and to encourage cable systems to carry such services in the basic tier." House Report at 82 (Emphasis added).[2/]

2. There is only one means by which this congressional objective can be realized: The Commission's rules setting standards for the regulation of basic tier rates must permit changes in the per subscriber fees paid by cable operators for the carriage of basic cable networks "to be passed through without prior regulatory review." NPRM at ¶ 83. The concept of a pass-through mechanism, in order to encourage cable operators to carry "a full range of services" in the basic tier (NPRM at ¶ 5), is not new. The use of such a mechanism was advanced in earlier proceedings before the Commission. It received widespread support from cable system operators, cable television networks and numerous other groups -- including franchising authorities -- which rarely find themselves in agreement with the cable television industry. See Reply Comments of USA Network in Response to Further Notice of Proposed Rulemaking in MM Docket No. 90-4, filed March 6, 1991.

2/ The Commission's assertion that the Cable Act of 1992 may be intended to "require" and "encourage" restructuring of the basic tier of service is misguided. NPRM at ¶ 5. In fact, the Cable Act requires restructuring only in the isolated case in which a distant signal that is not a superstation is now carried as a part of an upper tier; such a signal must either be deleted or placed in the basic tier. The notion that the Cable Act of 1992 is otherwise intended to "encourage" restructuring is entirely without foundation as a matter of law and policy. See also Comments of USA Networks and ESPN, Inc., in Docket 92-262 filed January 13, 1993.

It has now received legislative endorsement. House Report at p. 82.[3/]

3. A pass-through mechanism will permit cable operators to fully and quickly recover changes in the direct charges imposed by cable networks -- per subscriber fees -- that occur over time, without regulatory intervention or delay. The mechanism will not lead to unconstrained rate increases since program network charges represent only a small portion of the total costs upon which basic service rates are based. Cable operators have incentives, quite independent of rate regulation, to negotiate the most favorable per subscriber charges possible with the networks they carry. The lower the cost for cable service, the greater the number of subscribers. A pass-through mechanism allows the cable operator to continue to carry basic cable networks in the basic tier without a material rate impact upon subscribers and without economic burden to the cable operator.

4. At the same time, the pass-through mechanism assures that cable networks are, as Congress intended they should be, "fairly compensated" for the service and value of service they provide. The ability of cable networks to maintain and enhance the quality of service they provide (and, in some cases, the very survival of

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3/ The mechanism was not adopted in Docket R90-4 because the Commission evidently believed that the decision in ACLU v. FCC, 823 F.2d 1554 (D.C. Cir. 1987), precluded such a result. The changes which Congress has made to the Act and its expression of intent with respect to a pass-through mechanism renders the ACLU decision obsolete.

cable networks) is dependent upon access to the broadest possible audience in the basic tier. Access to audience drives the two revenue streams -- per subscriber fees and advertising revenues -- upon which cable network depend for their investment in innovative, high quality programming and new programming services. If cable network access to the basic tier is artificially constricted by rate regulation, basic cable networks would lose revenues from each source. Since the loss of advertising revenues is beyond the network's direct control, the cable network would have only two alternatives: to reduce its investment in new, higher quality programming or to raise its per subscriber fees -- the one revenue component it directly controls -- simply to maintain economic viability. The inevitable result is a spiral of increasing per subscriber fees leading to further decreasing audience access. Plainly, this would be detrimental to all sectors of the cable industry -- cable operators, cable networks and the creative industries. More importantly, the American public will either receive less attractive programming or pay more for it than they pay now. The pass-through mechanism provides cable networks with the ability, even in a re-regulated environment, to negotiate with cable operators for access to the broadest possible audience and for the per subscriber revenues they need to continue to provide better quality programming and more diverse program offerings.

5. The ultimate beneficiary of a pass-through mechanism is the cable subscriber. The mechanism will enable subscribers to continue to enjoy in the basic tier a broad range of alternatives to over-the-air television programs and to sample new program services as they are introduced. The public interest is not served by a rate regulation system which requires the distribution of off-air television service while denying (or increasing the cost of) subscriber's access to attractive, high quality and competitive alternative programming. In that regulatory environment, consumers either would pay dramatically more for the myriad of choices now available to them or receive a lot less programming for what they are now paying. Plainly these results must be avoided. A pass-through mechanism does so. It thus serves the overriding legislative goals of promoting and enhancing consumer choice.

6. In the NPRM, the Commission has asked that parties advocating a pass-through mechanism fully discuss its relationship to the ratemaking methodology that they recommend. NPRM at ¶ 83. The fact is that a pass-through mechanism can -- and should -- be made part of whatever ratemaking mechanism the Commission ultimately adopts. Historically, pass-throughs (e.g., fuel adjustment clauses) have been used in cost-of-service ratemaking.[4/]

4/ In its discussion of the direct cost of signals plus nominal contribution approach (NPRM at ¶ 54) the Commission notes the possibility of allowing operators to "pass on" direct programming cost. This approach does not, of itself, constitute a pass-through mechanism because the rates, including the full recovery of direct cost, would be subject to regulatory review. The essence of a pass-through mechanism is that it permits changes in direct

(continued...)

However, a pass-through mechanism can also be made a part of any one of the benchmarking approaches that the Commission has under consideration.

7. In its discussion of benchmarking, the Commission has correctly noted that some "adjustment mechanism" to change the benchmark over time will be required. NPRM at ¶ 49. This adjustment mechanism is likely to involve a price cap based upon the CPI or a more refined index. NPRM at ¶ 38. The pass-through mechanism readily fits with such a benchmark adjustment formula. The pass-through mechanism would govern future changes in rates resulting from changes in the direct costs -- per subscriber fees -- which would be automatically added to basic subscriber rates.[5/] In order to avoid consumer and franchising authority confusion, the pass-through should be permitted only at stated intervals -- e.g., every six months -- and should reflect the aggregate direct program cost increases actually incurred by the cable operator during the preceding period. Certain other direct costs which also serve special public interest values -- e.g., franchise fees -- might also be covered by the pass through. Changes in rates resulting from the pass-through would be excluded from the determination of

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4/(...continued)
programming costs to be added to rates without regulatory approval or intervention. The direct cost of signal approach is not a pass-through.

5/ We acknowledge that the mechanism has no application to the determination of the reasonableness of rates in effect when the new rules first take effect. It applies only to rate changes occurring thereafter.

whether the cable system is in compliance with the otherwise applicable benchmark.

8. By contrast, rate increases (excluding the pass-through) would be governed by the benchmark as adjusted over time through the price cap index, and would be subject to regulatory approval or review. Thus, the price cap system would be used for general changes in economic conditions; the separate pass-through mechanism accounts for changes in programming and similar costs because these are intimately related to diversity and consumer choice. Taken together, these mechanisms ensure that "consumer interests are protected in receipt of cable service" (P.L. 102-385 § 2(b)) to the fullest possible extent. They assure availability of a broad and diverse choice of programming in the basic tier at reasonable rates.

ALTHOUGH THE BENCHMARKING APPROACH SHOULD BE ADOPTED, IT SHOULD NOT BE BASED SOLELY ON PER CHANNEL APPROACH

9. The Commission suggests that it may be appropriate to develop its basic tier benchmark rate or rates by deriving or calculating (depending upon the methodology employed) a "per channel benchmark." It suggests that this is necessary to reflect "the different number of channels in different systems' basic tiers." NPRM at ¶ 41. But, there is an alternative method for determining the basic tier benchmark rate that also takes account of differences among cable systems in the size and composition of

the basic tier: The Commission should group systems based not only upon the number of channels in their basic tier but also on the diversity of the services in that tier. This alternative better serves the purposes of the 1992 Cable Act.

10. Per channel benchmarking is fundamentally defective because it assumes that the per channel cost to a cable operator of all channels carried in the basic tier is the same. The assumption is false. In fact, the per subscriber fees charged by cable networks vary markedly from service-to-service. They do so for a number of reasons, including the cost to cable networks of producing the programming, the popular demand for a particular program service, the opportunity afforded to the cable operator to sell advertising in conjunction with the service, the audience that the basic cable network reaches, and the extent and degree of competition among and between cable networks themselves. It is an illusion to think that an accurate benchmark can be developed simply by dividing the price (or cost) of the basic tier by the total number of channels in it.

11. The use of a per channel benchmark could have disastrous effects upon the choice of programming services available to subscribers. This test would actively encourage cable operators to discard high quality, more expensive cable networks and to replace them in the basic tier with less attractive, less costly alternatives. In order to obtain the programming that the subscriber wants, he would be forced to subscribe to upper tiers

and pay more than he is presently paying. This is not what Congress intended when it passed the Act.[6/]

12. The Commission itself has acknowledged that rules "designed to assure a low-priced, basic service tier ... could create incentives for cable systems to limit the basic service tier to the statutory minimum components." NPRM at ¶ 32. That is exactly what would happen if a per channel average rate were used to establish the benchmark. It is also exactly what Congress did not want to happen. The House Report emphasizes that the ratemaking formula applicable to initial rates must be "sufficiently flexible" to assure "full recovery" of the costs of providing basic tier service and "to encourage" the carriage of basic cable networks in the basic tier. House Report at 82. Congress did require that joint and common costs attributed to the basic tier be treated "in the same manner" as those in upper tiers "on a per channel basis." Id. However, it imposed no such stipulation upon the treatment of the direct cost of programming. Plainly, Congress understood the difference between a "low-priced"

6/ These results would be exacerbated if the Commission were to use past regulated rates as the starting point for the development of the benchmark. NPRM AT ¶ 44. Those rates simply do not reflect the truly impressive improvement in the quality of cable network programming that has occurred in the years since the Cable Act of 1984. It is clear that to the extent that basic subscriber rate increases were used to support the enhancement of basic cable network service, it was not the reason for the Congressional decision to reimpose rate regulation. House Report at 79. Even if it were otherwise a valid standard, the use of a per channel average that entirely ignores the advances in program choice and quality that have occurred in the past eight years plainly is not appropriate.

basic tier and "reasonable" basic tier rates, and it opted for the latter. It did so precisely to ensure continued availability of the best, highest quality program choice possible to basic tier cable subscribers. Neither the legislative goal nor the public interest is served by a formula which enables cable operators to fully recover programming costs only by debasing the quality and quantity of service in the basic tier. The per channel approach to benchmarking is too simple.

13. The alternative method suggested by the Commission -- grouping of systems on the basis of the number of services they carry in the basic tier and calculating an average basic tier rate for each group -- suffers a similar infirmity: the number of channels in the basic tier is an imperfect measurement. Grouping should be based upon the number and quality (diversity) of program sources in the basic tier. This benchmark recognizes that the inclusion of high quality cable networks in the basic tier serves the public interest, that the standard governing initial basic rates must fully reflect the legitimate differences in actual cost of carrying different cable networks, and that initial rate levels permitting full recovery of these costs is entirely reasonable. House Report at 79-82. This benchmark would minimize retiering associated with the reimposition of rate regulation; it would not penalize cable operators who have increased basic service tier rates in order to add new, innovative, high quality program service offerings to that tier. It is, therefore, a more accurate and

fairer measure of reasonable rates than the per channel approach and it serves the public interest better.[7/]

COMPLAINTS REGARDING UNREASONABLE UPPER TIER RATES SHOULD BE DECIDED ON A CASE-BY-CASE BASIS

14. The Commission indicates an intention to follow the same regulatory approach to rate regulation of "cable programming services" -- upper tiers -- under Section 623(c) that it has proposed for regulation of basic tier rates under Section 623(b): It proposes "to establish criteria" -- benchmarking or cost of service standards -- "to govern the determination" whether rates for cable programming service "are unreasonable." NPRM at ¶ 91. This misinterprets the statute and the basic policy underlying it. The Commission should deal with consumer and franchising authority complaints about upper tier rates on a case-by-case basis.

15. Section 623(c) states unequivocally that the determination of unreasonable rates is to be made "in individual cases." It does not mandate the adoption of a "formula." Rather, it enumerates the factors the Commission is to consider in making

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7/ For similar reasons, the Commission should not attempt to lower the initial benchmark to reflect revenues earned by cable operators from the sale of advertising associated with the carriage of basic cable networks. Although these revenues may affect system profitability, they do not influence the cost of providing cable service and have no relevance to the supposed power of some cable systems to extract "monopoly rents" (NPRM at ¶ 94) from their subscribers. Even in classic rate of return regulation, these revenues would be accounted for "below-the-line" and excluded from the standard used to define whether consumer rates are reasonable. For the same reasons, that approach should be followed here.

such determinations. Among other matters, the Commission is specifically directed to consider the "history of the rates" for upper-tiered services and, most importantly, the "rates, as a whole, for all cable programming" -- including the basic tier -- offered by the system. Section 623(c)(2)(C) and (D). (Emphasis added). It is not possible to develop "criteria" or formulaic tests -- whether on benchmarking or any other basis -- that fully effectuate the factors the Commission must consider under § 623(c).

16. The use of a cost of service approach to the regulation of the upper-tiers would invite the very "trade-offs" (NPRM at ¶ 94; see House Report at 86) that Congress was seeking to avoid. Benchmarking is equally unworkable in the context of Section 623(c). While benchmarking is definitionally based upon comparisons, there are too many factors for the Commission to consider under Section 623(c) and they cannot be incorporated into a single norm. The absolute level of upper-tier rates is only one element to be considered. The composition of the basic and of the upper-tier are central to the determination, under § 623(c)(2)(D), whether the rates of the system "as a whole" are consonant with the public interest. So is penetration --subscriber acceptance -- at both basic and upper-tier levels. Further, the relationship between basic and upper-tier rates -- the "gap" -- must be weighed under § 623(c)(2)(D). Lastly, benchmarking entails the establishment of the norm at a fixed moment in time, and does not take into consideration the prior "history" of upper-tier rates as required

by § 623(c)(2)(C). In sum, upper-tier rates may not be unreasonable even though they exceed some calculated or derived benchmark norm.

17. These variables cannot be forced into a simple standard. Greater flexibility in evaluating the "unreasonableness" of upper-tier rates than permitted by the Commission's proposed "criteria" is required. The determinations under Section 623(c) must be made on the basis of the specific facts of each "individual case" -- as the statute itself commands.

Respectfully submitted

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